



**DEFENSE CONTRACT AUDIT AGENCY**  
**DEPARTMENT OF DEFENSE**  
8725 JOHN J. KINGMAN ROAD, SUITE 2135  
FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PSP 730.4.A.11

January 6, 2005  
05-PSP-003(R)

**MEMORANDUM FOR REGIONAL DIRECTORS, DCAA**  
**DIRECTOR, FIELD DETACHMENT, DCAA**

**SUBJECT:** Audit Guidance on Purchased Insurance, and Notification of Related Improper Insurance Practices Identified in Complaints Filed by the New York Attorney General

This memorandum provides notification of the improper insurance practices identified in two complaints filed by the New York Attorney General that may impact contractors' purchased insurance costs, and provides related audit guidance.

**Background**

Recently, the New York Attorney General sued two large insurance brokerage firms, Marsh and McLennan and Universal Life Resources, Inc., for fraud and antitrust violations. The complaints allege that these brokers:

- steered unsuspecting clients to insurers with whom the brokers had lucrative payoff agreements and
- solicited rigged bids for insurance contracts.

The New York Attorney General has named several insurance companies as participants in the bid-rigging. The lawsuits relate to numerous types of insurance that include excess workers' compensation, employee group benefits, property and casualty, and excess liability. We have learned that other insurance companies are also under investigation. The New York Attorney General has stated that it appears that the practices identified in the lawsuits are widespread in the insurance industry.

**Guidance**

At contractor locations where purchased insurance costs are significant, auditors should ascertain whether the contractor purchases its insurance through a broker. If insurance is purchased through a broker, the auditor should determine whether the contractor has procedures in place to ensure that the premiums paid are fair and reasonable. This should be accomplished in a current audit where deemed feasible (e.g., forward pricing rate, proposal audit, or incurred cost audit). The contractor's procedures should ensure that the broker provides sufficient evidence for the contractor to establish the reasonableness of the price (e.g., competitive insurance quotations obtained by the broker). Based on the data provided,

**SUBJECT: Audit Guidance on Purchased Insurance, and Notification of Related Improper Insurance Practices Identified in Complaints Filed by the New York Attorney General**

the contractor should adequately document its basis for choosing a particular insurer. If the contractor does not currently have adequate procedures in place, auditors should issue a purchasing system flash report (CAM 10-413). If the contractor decided not to purchase insurance from a company with the lowest premium and the contractor does not provide an adequate explanation for its decision, auditors should question any costs determined unreasonable.

At contractor locations where a broker is not used to purchase insurance, auditors are reminded that they should evaluate the reasonableness of the subject costs, if deemed significant, during future audits.

- During future forward pricing rate and proposal audits, auditors should review the contractor's support for determining the fair and reasonable prices for the estimated purchased insurance (for example, ascertaining whether the contractor obtains competitive quotations). If the contractor does not have adequate procedures in place to support the reasonableness of its proposed insurance costs, the auditor should issue an estimating system flash report (CAM 9-310 & 10-413) and question costs determined unreasonable.
- During future incurred cost audits, auditors should also review the contractor's support for price reasonableness of purchased insurance costs and question costs determined unreasonable (CAM 6-310). If the contractor does not currently have adequate procedures in place to ensure purchased insurance costs are reasonable (e.g., contractor obtains competitive quotations), auditors should issue a purchasing system flash report (CAM 10-413).

### **Concluding Remarks**

Field audit office personnel should direct questions regarding this memorandum to personnel in the regional office. If regional personnel are unable to answer or have questions of their own, they should contact Susan Katterheinrich, Program Manager, Policy Special Projects Division, at (703) 767-3290 or email at DCAA-PSP@dcaa.mil.

/Signed/

Robert DiMucci  
Assistant Director  
Policy & Plans

DISTRIBUTION: C